

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:NER:MAN:TL-N-2331-98
SDTillem

date:

to: Chief, Manhattan Appeals Office
Attention: Appeals Officer Irwin Lieberman

from: District Counsel, Manhattan

subject:

[REDACTED]
EIN: [REDACTED]
Interest on Deficiencies
Taxable Year March 31, [REDACTED]
U.I.L. # 6601.01-00

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to the taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

This advice assumes that the facts are as represented herein.

This advice is subject to 10 day post review by the National Office. Accordingly, we request that you do not act on this advice until we have advised you of the National Office's comments, if any, about this advice.

This memorandum is in response to your request for advice concerning when underpayment interest begins to accrue on [REDACTED]'s (" [REDACTED] ") deficiency in tax for the tax year [REDACTED]. We have spoken with Richard Fultz of the National Office regarding this issue.

ISSUE

On what date does underpayment interest begin to accrue on [REDACTED]'s deficiency in tax for tax year [REDACTED] where [REDACTED] reported an overpayment of tax on its [REDACTED] return and elected to have the overpayment applied to estimated taxes for the succeeding year.

CONCLUSION

On the facts provided, underpayment interest on [REDACTED]'s deficiency in tax of \$ [REDACTED] for tax year [REDACTED] begins to accrue on [REDACTED].

FACTS

[REDACTED] timely filed its [REDACTED] Form 1120 U.S. Corporation Income Tax Return under extension, on [REDACTED]. The return showed an overpayment of \$ [REDACTED] which the taxpayer elected to apply to its estimated taxes for the following taxable year ending [REDACTED]. Since the taxpayer did not specify the installment to which the overpayment was to be applied, the Service applied the overpayment to the first installment for [REDACTED] pursuant to Revenue Ruling 88-98, 1988-2 C.B. 356.

On [REDACTED], as a result of an audit of the taxpayer's [REDACTED] year, the Service assessed \$ [REDACTED] in tax. Interest of \$ [REDACTED] was assessed on the deficiency on [REDACTED]. Both amounts were paid in full by the taxpayer through an advance payment made on [REDACTED] of \$ [REDACTED]. The taxpayer made an additional subsequent payment on [REDACTED] of \$ [REDACTED]. In error, the Service applied this additional payment to [REDACTED]. When this additional payment was

correctly applied to [REDACTED] it resulted in an \$[REDACTED] abatement of interest assessed. An additional abatement of interest of \$[REDACTED] was made on [REDACTED] as a result of the Service moving the beginning interest assessment date on the \$[REDACTED] tax deficiency from the [REDACTED] due date for the [REDACTED] return to [REDACTED], the date the credit elect from [REDACTED] was applied to the succeeding year's estimated taxes.

The taxpayer through a combination of payments and allocated portions of the credit elect from [REDACTED] made estimated quarterly payments for [REDACTED] sufficient to avoid estimated tax penalties.¹ The taxpayer allocated the credit elect from [REDACTED] of \$[REDACTED] to [REDACTED] estimated tax payments as follows:

<u>Payment</u> <u>Due Date</u>	<u>Amount Due</u>	<u>Deposit</u>	<u>Application</u> <u>Of Credit Elect</u>	<u>Total</u>
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	-	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

The Service received a claim from the taxpayer dated [REDACTED] [REDACTED], requesting removal of \$[REDACTED] interest charged on the deficiency assessed for tax year [REDACTED] on the basis that interest on the deficiency should have begun running from [REDACTED] (the due date of the fourth installment for

¹ Installment due dates are the 15th day of the 4th, 6th, 9th, and 12th months of the tax year pursuant to I.R.C. § 6655(i)(1). Underpayment penalties under I.R.C. § 6655 are imposed on the difference between payments made by the due date of the installment and the required installment amount, based on the lesser of (1) 90 percent of the tax shown on the return; or (2) 100 percent of the tax shown on the preceding year's return. The taxpayer's income tax liability for [REDACTED] was \$[REDACTED]. Accordingly, the taxpayer calculated the quarterly installment due was \$[REDACTED] (equaling 90% of \$[REDACTED] divided by 4).

██████ as opposed to running from ██████████ as claimed by the Service. The taxpayer argued that pursuant to Avon Products interest on the deficiency should not run until the due date of the fourth installment because the first three installments for ████████ had been timely paid, through a combination of payments and allocated portions of the credit elect. A copy of the taxpayer's claim dated ██████████ is attached.

The IRS' Austin Service Center sent the taxpayer a letter dated ██████████ denying the taxpayer's claim for removal of interest charged on the deficiency for tax year ████████ on the basis that: "the first and second estimated tax installments for ████████ were not fully paid indicating that the credit elect was intended for application to the third quarter estimated tax installment". A copy of the letter from the IRS Austin Service Center dated ██████████ is attached.

The taxpayer protested the denial of its claim for interest abatement and the case was assigned to ██████████. The taxpayer sent a letter to ██████████ dated ██████████ revising its position by claiming that interest on the deficiency for taxable year ████████ should begin running on ██████████, the date of filing the 8709 Form 1120 (not on ██████████). ██████████ contacted ██████████ District Counsel requesting advice as to whether interest on the taxpayer's deficiency for ████████ should run from ██████████ as claimed by the Service or from ██████████ as currently claimed by the taxpayer.

DISCUSSION AND ANALYSIS

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due. I.R.C. § 6601(a). If a deficiency in tax is determined after the taxpayer elected to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit elect. H.R. Rep. No. 98-432(Part 1), 98th Cong., 1st Sess. 190(Oct.21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income

tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.² Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election. 1977-2 C.B. at 476 (emphasis added).

Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432(Part 1), 98th Cong., 1st Sess. 190(Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally was crediting a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that designated otherwise. However, in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind this default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed to be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment and the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996). On August 4, 1997, the Service acquiesced in the May Department Stores decision. May Department Stores Co. v. United States, action on decision provides that:

² In 1983, the Service revoked Revenue Ruling 77-475. Rev.Rul. 83-111, 1983-2 C.B. 245. However, on March 30, 1984, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475.

for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return. May Department Stores Co. v. United States, AOD CC-1997-008 (Aug. 4, 1997).

The taxpayer applied \$[REDACTED] of its credit elect from [REDACTED] to pay part of the first installment of taxes for [REDACTED] due on [REDACTED]. Interest on the deficiency accrues on the due date of the installment of estimated tax against which the overpayment was credited pursuant to Revenue Ruling 88-98, 1988-2 C.B. 356. Accordingly, interest on the taxpayer's deficiency in tax for the tax year [REDACTED] begins to accrue on [REDACTED].

Should you have questions regarding this memorandum, please contact Steven D. Tillem at (212) 264-1595 extension 291.

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By: _____
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Enclosures

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